**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

Rulemaking on the Commission's Own Motion to Govern Open Access to Bottleneck Services and Establish A Framework for Network Architecture Development of Dominant Carrier Networks.	Rulemaking 93-04-003 (Filed April 7, 1993)
Investigation on the Commission's Own Motion into Open Access and Network Architecture Development of Dominant Carrier Networks.	Investigation 93-04-002 (Filed April 7, 1993) (Verizon UNE Phase)

RESPONSE OF CBEYOND COMMUNICATIONS, LLC (U-6446-C), COVAD COMMUNICATIONS COMPANY (U-5752-C), THE DIVISION OF RATEPAYER ADVOCATES, DMR COMMUNICATIONS, INC. (U-6735-C), MPOWER COMMUNICATIONS CORP. (U-5859-C), NAVIGATOR TELECOMMUNICATIONS, LLC. (U-6167-C), AND XO COMMUNICATIONS SERVICES, INC. (U-5553-C) TO APPLICATION OF VERIZON CALIFORNIA INC. (U 1002 C) FOR REHEARING OF D.06-03-025

May 4, 2006

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CALIFORNIA PUBLIC UTILITIES COMMISSION RULES OF PRACTICE AND PROCEDURE

Pursuant to Rule 86.2 of the Commission's Rules of Practice and Procedure, Cbeyond Communications, LLC (U-6446-C), Covad Communications Company (U-5752-C), the Division of Ratepayer Advocates ("DRA"), DMR Communications, Inc. (U-6735-C), MPower Communications Corp. (U-5859-C), Navigator Telecommunications, LLC. (U-6167-C), and XO Communications Services, Inc. (U-5553-C) (collectively, "Joint Respondents") respectfully submit their Response to the **Application of Verizon California Inc. (U 1002 C) for Rehearing of D.06-03-025**, filed April 19, 2006 (hereinafter, "Rehearing Application").

DRA participated in this proceeding, submitting testimony and comments.[1] DRA is statutorily charged with the task of protecting the interests of California utility consumers. Inasmuch as competition is expected to provide consumer benefits, such as lower prices, DRA participated in this proceeding in order to try to maximize competitive choices for consumers and ensure that Verizon would not recognize windfall profits from the "permanent" unbundled network element ("UNE") rates established by the Commission. DRA joins this response to Verizon's Rehearing Application for these reasons, and also to correct misrepresentations of the record evidence which are contained in Verizon's Rehearing Application.

I. INTRODUCTION

Verizon's attacks on Decision (D.) 06-03-25 (the "Final Decision")[2] largely rehash arguments that it made in previous rounds of comments. Indeed, portions of Verizon's Rehearing Application are merely copied from its comments on the draft decision; thus, the Commission already has considered, and properly rejected, each of these arguments in its Final

[1] DRA was formerly known as the Office of Ratepayer Advocates, which is the name used on testimony and comments filed in this proceeding.

[2] Rulemaking on the Commission's Own Motion to Govern Open Access to Bottleneck Services and Establish a Framework for Network Architecture Development of Dominant Carrier Networks, R.93-04-003; Investigation on the Commission's Own Motion into Open Access and Network Architecture Development of Dominant Carrier Networks, I.93-04-002 [D.06-03-025], __ CPUC 2d __, 2006 Cal.

Decision. The Commission certainly should not reward Verizon for regurgitating the same failed arguments.

None of Verizon's alleged material errors is, in fact, a valid basis for rehearing. To the contrary, if the Commission were to grant rehearing on the cost of capital issues, it would find that it needs to *reduce* the adopted cost of capital, not to increase it, as Verizon claims. Similarly, if the Commission were to grant rehearing on the DS-3 loop and DS-1 loop and transport issues, it would find that it needs to *reduce* those prices, not to increase them, as Verizon alleges.

Finally—and despite the generous UNE prices adopted in D.06-03-025—Verizon asks the Commission to rule that implementation of a true-up provision in D.06-03-025 would constitute unlawful retroactive ratemaking. The Joint Respondents demonstrate below that Verizon's arguments in support of this claim (a) implausibly ask the Commission to disregard its 2003 imposition of a UNE price adjustment clause (which was reiterated in 2005), (b) reflect a complete misunderstanding of the rule against retroactive ratemaking and (c) would cause, if adopted by the Commission, a severe injustice for the competitive local exchange carriers ("CLECs") that relied on earlier Commission decisions instituting interim UNE prices.

Verizon has no reason to be dissatisfied with the outcomes of the Final Decision. If anything, the Final Decision errs in being too generous to Verizon. Thus, the Commission should dismiss Verizon's rehearing application. If it does not, the Commission should thereby grant a rehearing on the issues that tend to inflate the UNE costs and prices adopted in D.06-03-025. The ultimate outcome of any fair and reasoned evaluation of the evidence would result in UNE prices that are less than or equal to the prices that the Commission already has adopted.

P.U.C. LEXIS 107 (dated March 15, 2006) (hereinafter, "D.06-03-025" or the "Final Decision").

II. DISCUSSION

A. Verizon's Arguments Concerning the Adopted Cost of Capital Have No Merit.

1. Verizon's Attack on the Adopted Capital Structure Errs in Several Respects

Verizon contends that the adopted capital structure violates Total Element Long Run Incremental Cost ("TELRIC") standards and that only Verizon's proposed "market value" capital structure meets the forward-looking requirements of TELRIC.[3] This contention is incorrect on many levels.

First, the record shows that the first choice of financial economists for developing a forward-looking estimate of the cost of capital is a *target* capital structure for *future* investments, not a backward-looking view of the market capital structure for past investments. For example, Ibbotson Associates states that "[i]deally, a firm's target or optimal capital structure should be used in weighting the cost of equity and cost of debt."[4] Other experts, including Professor Glenn Hubbard (former Chairman of President Bush's Council of Economic Advisors), agree. In an essay co-authored with Dr. William Lehr, Professor Hubbard explained that historical market valuations are not appropriate for determining capital structure weights for a TELRIC study. According to Hubbard and Lehr:

> Rather, the relevant market weighting is the target weighting of debt and equity that an informed management team would employ over the long run. This target weighting almost certainly has much less equity, and much more debt, than the current market weightings.[5]

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[3] Rehearing Application, pp. 2-3.

[4] Ibbotson Associates, *SBBI Valuation Edition, 2003 Yearbook*, p. 14, cited in Murray Decl., 11/3/03, ¶ 138.

[5] R. Glenn Hubbard and William H. Lehr, "TELRIC and the Cost of Capital," at 4.13. This essay was included in a set of essays entitled *Pricing Based on Economic Cost: The Role and Mechanics of TELRIC*, submitted by AT&T as an *ex parte* presentation to the FCC in the *TELRIC NPRM* docket, on December 6, 2003, and is quoted on the record in this proceeding in JC/Murray Decl., 8/6/04, ¶ 129.

The Final Decision uses available data for both market and book capitalization as a means of *forecasting* the target capital structure for an efficient incumbent local exchange carrier ("ILEC") providing UNEs.[6] The result is a capital structure that, if anything, overstates the proportion of common equity likely to exist in an efficient telecommunications carrier's target capital structure.

For example, the Final Decision's adopted capital structure of 66.44% equity and 33.56% debt contains substantially more common equity than did the 57% equity and 43% debt capital structure adopted in the SBC UNE reexamination order.[7] The Commission observed that the 57% equity and 43% debt capital structure adopted in D.04-09-063 was consistent with the (proprietary to that record) target capital structure information provided by SBC.[8] Thus, the Final Decision's adopted capital structure for Verizon appears to give far heavier weight to common equity than SBC includes in its internal capital structure goals.

Similarly, the Final Decision's adopted capital structure contains slightly more common equity than even the high end of the range that BellSouth apparently uses in determining how to finance its investments. In a public data response provided as Exhibit TLM-6 to Ms. Murray's 11/3/03 declaration, BellSouth stated that:

The Final Decision cites to this evidence (D.06-03-025 at 76), but describes the evidence in a way that leads to Verizon's misleading claims about the convergence of market and book equity. (Rehearing Application, p. 4.) As the quotation in the body of the text above reveals, Professor Hubbard and Dr. Lehr find that the *long-run* target capital structure (whether market or book) would contain more debt, and less equity, than the *short-run* (recent historical) market capital structure data on which Verizon relies. Joint Respondents suggest that the Commission may eliminate any confusion on this point by replacing the discussion of the Hubbard and Lehr evidence on page 76 of the Final Decision with the direct quotation contained in the main text above, which fully supports the adopted capital structure.

[6] D.06-03-025 at 77.

[7] D.04-09-063, *slip op.*, at 170, Table 6. Largely as a result of the higher equity ratio, the Final Decision's adopted weighted-average cost of capital (after-tax) of 10.23% is 79 basis points higher than the 9.44% cost of capital adopted for SBC.

[8] D.04-09-063, *slip op.*, at 169.

> For planning purposes, BellSouth Telecommunications, Inc., targets a debt ratio of 35% to 45%. This range allows BST to target *an optimal weighted average cost of capital* while maintaining financial flexibility and capital access. [emphasis added]

This information from BellSouth[9] is precisely the kind of data that Ibbotson Associates and other experts recommend for use in a forward-looking cost of capital analysis and therefore confirms that the Final Decision's proposed capital structure contains more than ample common equity. Increasing the equity ratio to 75%, as Verizon recommends, would put the equity proportion of the capital structure far higher than the available data suggest is appropriate for a telecommunications carrier's target capital structure.

Second, the "market value" capital structure that Verizon proposes is based on Dr. Vander Weide's review of *historical* data from 1998 through 2002 concerning the market's valuation of the *embedded* assets held by telecommunications holding companies and by a subset of the S&P Industrials.[10] The valuation of the S&P Industrials has nothing to do with the telecommunications industry whatsoever and provides no guidance as to how an efficient carrier would finance a forward-looking network to provide UNEs. Also, as Joint Commentors' expert Ms. Murray explained, "the valuation of the company's embedded assets says very little about the mix of debt and equity which Verizon California (or any other firm) is likely to use to fund

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[9] Verizon's Rehearing Application claims, without any specific citation, that the record evidence concerning target capital structure is irrelevant because the evidence refers to a target *book* capital structure, rather than a target *market* capital structure. Rehearing Application, p. 4. As the quotation in the main body of the text above reveals, the data response from BellSouth does not in any way mention or refer to a target *book* capital structure, but merely to a target "for planning purposes." This "planning purposes" target comports precisely with the expert opinion from Ibbotson Associates and Hubbard and Lehr, also cited and quoted in the main text above, concerning the proper capital structure measure to use in determining the forward-looking cost of capital.

[10] Verizon/Vander Weide Direct, 11/3/03, pp. 39 and 41. Dr. Vander Weide updated his cost of capital recommendation in his 8/6/04 Reply (p. 70), but did not update the capital structure. Verizon's Rehearing Application discusses capital structure data for 1996 through 2003 (Rehearing Application, p. 3), citing Dr. Vander Weide's rebuttal testimony.

new investments."[11] Indeed, the holding company valuations reflect not only the value of their embedded network assets, but also of many lines of business such as long-distance, DSL and wireless that have nothing to do with the UNEs being priced in this proceeding.

Third, Verizon's suggestion that a TELRIC study cannot make any use of book capitalization data in forecasting the forward-looking mix of debt and equity is the equivalent of saying that the Commission cannot consider the existing ratios of expenses to investments ("E:I ratios") in developing its view of the likely forward-looking expenses. Thus, Verizon's suggestion calls for an extreme and highly skewed approach. Both Verizon and Joint Commentors make use of such "embedded" information regarding expense-to-investment ratios in their UNE cost studies, and the Wireline Competition Bureau endorsed the use of E:I ratios as a technique for estimating forward-looking expenses.[12] The Final Decision's use of information about existing capitalization ratios as one input to projecting forward-looking capitalization is entirely consistent with this precedent. The Final Decision's approach to forecasting a target capital structure is also consistent with Verizon's own advocacy of such actual historical data as the relative proportions of new vs. growth lines Verizon purchased over the past five years to determine the forward-looking cost of unbundled switching. Indeed, the Final Decision adopts Verizon's proposal to base the weightings of new vs. growth lines on historical data (Final Decision at 105), and Verizon continues to support that approach. Thus, Verizon's position concerning the capital structure weightings is inconsistent with other positions it has taken in this same proceeding.

[11] JC/ Murray Decl., 8/6/04, ¶ 128.

[12] *In re: Petition of WorldCom, Inc.*, 17 FCC Rcd. 27,039 (Jul. 17, 2002) (hereinafter, "*Virginia Arbitration Order*"), ¶ 141 (endorsing use of E:I ratios, with embedded investments adjusted by a Current Cost to Book Cost ratio, for development of plant-specific expenses).

Verizon's counterarguments to this evidence in support of using a target capital structure in a TELRIC study are off the mark. For example, Verizon argues that market values in 2003 tended to exceed book values, and that market values for the S&P Industrials generally exceeded book values for the period 1946-1988.[13] A cross-sectional sample for 2003 does not provide any evidence about long-run tendencies. Moreover, the S&P Industrial data on which Dr. Vander Weide and Verizon rely to make this claim reflect the valuation of a changing base of embedded assets for these companies and do not indicate how the companies have chosen to finance new investments. Thus, even if it were correct that the historical market value capital structures for the firms studied by Dr. Vander Weide remained "very stable" for many years,[14] that information could not outweigh the direct information concerning the optimal weights of debt and equity in the capital structures used by comparable telecommunications firms such as BellSouth to finance new investments.

For all of these reasons, the Commission should affirm the Final Decision's adopted capital structure of 66.44% equity and 33.56% debt as a reasonable—indeed, generous—forecast of Verizon's forward-looking target capital structure and one that complies with TELRIC principles.

2. Verizon Fails to Demonstrate Any Valid Basis for Its Proposed Risk Adder

Verizon suggests that a 2.74% adder to the weighted-average cost of capital (which equates to a 3.65% adder to the cost of equity) is necessary to compensate Verizon for the unique

[13] Rehearing Application, p. 4.

[14] *Ibid.*, p. 3. To the extent that Verizon relies on extra-record material from *ex parte* presentations to support this claim, the Commission must ignore that material. Commission decisions must be based on the record evidence. Rule 1.2.

risks of the TELRIC standard.[15] To the contrary, such an adder would produce UNE rates that would far exceed TELRIC-compliant prices.

The record provides ample evidence for the Commission to reject Verizon's proposed adder. Although Verizon claims that the Final Decision errs in finding the risks of UNEs and retail rates to be the same,[16] Verizon's own cost of capital witness Dr. Vander Weide has testified in Washington state that, on a forward-looking basis, the same risks he cited in support of his proposed UNE risk adder apply to retail rates as well.[17] Yet, in this proceeding, Verizon not only proposes that the 2.74% cost of capital adder apply only to UNE costs (and not to retail price floors), it also rationalizes this adder as being necessary to capture risk unique to UNEs under TELRIC rules.[18] A risk that applies equally to retail rates, by definition, cannot be a risk unique to UNEs.

Further, Verizon is simply wrong in alleging any inconsistency between the Commission's findings concerning the Capital Asset Pricing Model ("CAPM") in D.04-09-063 versus its findings in this Final Decision.[19] In the Final Decision, the Commission *increased* the beta coefficient in the CAPM to 1.0 relative to the 0.93 beta used in D.04-09-063, specifically making this adjustment (consistent with the precedent of the Wireline Competition Bureau's *Virginia Arbitration Order*) to account for the risks associated with the TELRIC methodology for UNE pricing.[20] There is no need for further quantitative adjustment to the CAPM.

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[15] Rehearing Application, p. 5.

[16] *Ibid.*

[17] Washington Utilities and Transportation Commission Docket No. UT-023003, *In The Matter of the Review of Unbundled Loop and Switching Rates And Review of the Deaveraged Zone Rate Structure*, Tr. Vol. 11 (May 26, 2004), 577:23 – 578:17 (Vander Weide). A copy of this testimony was provided as Exhibit TLM-REP-5 to JC/Murray Decl., 8/6/04.

[18] Rehearing Application, pp. 5-6.

[19] *Ibid.*, pp. 6-7.

[20] D.06-03-025 at 71-72.

Verizon is also wrong in referring to Dr. Vander Weide's "general" demonstration of the risks associated with UNEs that allegedly are not captured by the CAPM.[21] The risks to which Verizon refers (of changing prices during the life of the network assets and of customers leaving Verizon's network) apply equally to retail rates, yet as noted above, Verizon did not apply its risk adder to retail rates. Moreover, Dr. Vander Weide's calculation of the lease cancellation risk premium is a one-sided view of the risks and benefits of Verizon California's "sunk" investments. In particular, when one recognizes that Verizon California's network assets have many revenue-generating uses other than the provision of UNEs, it becomes obvious that the company may in fact be better off if a CLEC "cancels" its option to lease UNEs because Verizon would then have the opportunity to earn revenues for its retailing operations as well as the use of its network. Thus, the risk "adder" should actually be a risk "subtractor" that would *reduce* the cost of capital for UNEs relative to retail rates.[22]

Even if there were no theoretical objection to Dr. Vander Weide's "lease cancellation" risk premium, the Commission could not adopt the proposed risk adder because Dr. Vander Weide's calculation of the adder is technically flawed and lacks supporting documentation.[23] Similar technical flaws led the Staff of the Florida Public Service Commission to recommend rejection of Dr. Vander Weide's proposal in that state.[24]

Finally, and contrary to Verizon's claim,[25] the proposed risk adder in this proceeding is substantially comparable to the one that the Commission rejected in the 1999 Pacific Bell UNE pricing decision. In both instances, the incumbents proposed "option-value" adders were based

[21] Rehearing Application, p. 7.
[22] JC/ Murray Decl., 8/6/04, ¶¶ 139, 171-177.
[23] *Ibid.*, ¶¶ 186-194.
[24] *See ibid.*, ¶ 194, for a detailed description of the flaws identified by the Florida staff.
[25] Rehearing Application, p. 7.

on the argument that the incumbents incur sunk and irreversible costs to provide UNEs and that the TELRIC methodology fails to provide full compensation for these costs.[26] This Commission, the FCC and a federal district court judge for Northern California have all rejected those arguments,[27] and Verizon has provided no valid basis for reconsideration here. Instead, as the FCC has found, the combination of TELRIC-compliant depreciation schedules and a market-based cost of capital is sufficient to address the relevant risk.[28]

3. The New Hampshire Federal District Court Opinion Does Not Necessitate Modifications to the Final Decision's Proposed Cost of Capital

In the Rehearing Application, Verizon contends that its proposed corrections to the Final Decision's cost of capital are necessary to bring the Final Decision into compliance with a 2005 federal district court decision in *Verizon New Hampshire Inc. v. New Hampshire Pub. Utils. Comm'n.*[29] Verizon does not, however, discuss how the original New Hampshire Public Utilities Commission ("PUC") determination compares to the Final Decision's approach. Had Verizon supplied that information, it would have been immediately apparent that the New Hampshire federal district court opinion has no bearing on the merits of the Final Decision.

The original New Hampshire PUC cost of capital order adopted a weighted-average cost of capital of 8.2%. The adopted capital structure included only 45% equity and 55% debt.[30] On its face, the New Hampshire PUC order is far different from the Final Decision, which adopts a

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[26] *Ibid.*, ¶¶ 142-145.

[27] *Ibid.*

[28] First Report and Order, *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 (CC Docket No. 96-98); Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers (CC Docket No. 95-185)*, FCC No. 96-325, rel. Aug. 8, 1996, ¶¶ 688, 703.

[29] Rehearing Application, pp. 2 and 6.

[30] *Verizon New Hampshire, Inc. v. New Hampshire Public Utilities Commission*, No. 04-CV-65-PB, slip op. at 5 (D.N.H. Aug. 17, 2005), 2005 U.S. DIST. LEXIS 17200 (hereinafter, "*New Hampshire Decision*").

10.23% weighted-average cost of capital based on a capital structure of 66.44% equity and only 33.56% debt.[31]

The differences between the two orders are even more apparent when one looks to the methodologies on which each order's results are based. The New Hampshire PUC relied entirely on book value data for Verizon New England to develop its adopted capital structure.[32] Similarly, the New Hampshire PUC used the embedded cost of Verizon New England's debt.[33] Finally, the New Hampshire PUC based its adopted cost of equity on the results of a three-stage Discounted Cash Flow ("DCF") analysis with inputs that the district court determined to have been selected in a manner designed to replicate Verizon's historical stock price, dividend and growth rate.[34] In contrast, as discussed herein, the Final Decision uses a target capital structure, Verizon's own proposed measure of the forward-looking cost of debt,[35] and the CAPM methodology for estimating the cost of equity. Thus, the *New Hampshire Decision* is inapposite.

Verizon quotes the *New Hampshire Decision* as stating that "increased risk necessarily results in an increased cost of capital."[36] This quotation must be read in context. According to the district court opinion, New Hampshire state law requires that retail rates be set using a rate-of-return or embedded cost methodology. The New Hampshire PUC sought to justify use of the retail cost of capital (established using the historical cost methodology described in the prior paragraph) for UNEs on the basis that Verizon failed to meet the burden of proof that the provision of UNEs subject to facilities-based competition is riskier than is the provision of retail

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[31] D.06-03-025 at 80.

[32] *New Hampshire Decision* at 3.

[33] *Ibid.* at 4.

[34] *Ibid.* at 12.

[35] The primary alternative proposal for the cost of debt in this case—the forward-looking yield-to-maturity of Verizon-specific bonds, as proposed by Joint Commentors' witness Ms. Murray and adopted in the *Virginia Arbitration Order*—also is strikingly different from the methodology adopted by the New Hampshire PUC.

services in a rate-of-return regulated environment. The district court rejected the New Hampshire PUC's attempt to impose this burden of proof on Verizon.[37]

In California, however, it has been over 15 years since the CPUC ceased to regulate Verizon's retail rates using a rate-of-return methodology. Further, as noted above, the record of this proceeding shows that Verizon's own cost of capital witness has conceded that the risks he associates with UNEs are also associated with retail services.[38] Thus, the apparent contradiction between the retail and UNE ratemaking methodologies that led the federal district court to reject the New Hampshire PUC's decision to adopt the same cost of capital for retail rates and UNEs does not apply in California.

Neither the result nor the methodologies employed in the Final Decision bear any resemblance to the New Hampshire cost of capital order at issue in the *New Hampshire Decision*. There is no reason for the Commission to modify the Final Decision in an attempt to accommodate a district court opinion relating to such a dissimilar set of facts.

4. If Anything, the Commission's Adopted Cost of Capital Is Too High Because the Cost of Equity Calculation Erroneously Relies on Outdated Data from the Record of the SBC Proceeding

The Final Decision derives its adopted 12.3% cost of equity by substituting a beta of 1.0 into the CAPM formula used to derive the cost of equity in D.04-09-063, the SBC California UNE re-examination order, keeping all other inputs the same.[39] In so doing, the Final Decision departs from both the CAPM methodology adopted by the Wireline Competition Bureau in its

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[36] Rehearing Application, p. 6.

[37] *New Hampshire Decision* at 12-14. Ironically, this opinion makes clear that "the Telecommunications Act does not flatly prohibit embedded cost methods such as the one that the [New Hampshire] PUC used in this case" (*ibid.* at 14) and that it may well be true that TELRIC does not bar a state commission from setting the same cost of capital for both retail prices and UNEs (*ibid.* at 11-12). Thus, the district court opinion does not create the kind of bright-line standard that Verizon seeks to imply now exists.

[38] *See* n. 17, *supra*.

Virginia Arbitration Order and the portion of Ms. Murray's CAPM calculation on which the Final Decision relies to corroborate the "reasonableness" of its result.[40]

The record shows that the cost of equity calculated using the Final Decision's adopted CAPM methodology, with a beta of 1.0 and the most recent market risk premium and risk-free interest rate data in the record of the Verizon proceeding, would be 12.03%.[41] As noted above, the Final Decision cites to these data to corroborate the result derived from selectively updating the beta coefficient, but not the Ibbotson risk premium or the risk-free interest rate, from the D.04-09-063 analysis. No party to the Verizon proceeding recommended using the outdated Ibbotson risk premium or risk-free interest rate inputs from the SBC proceeding, rather than the corresponding, but more recent, data in the Verizon record. Thus, the Commission should correct the Final Decision to adopt a cost of equity of 12.03% and should adopt a corresponding reduction in the cost of capital, bringing the corrected weighted-average cost of capital to 10.06%.[42]

B. <u>Verizon's Arguments Concerning the Adopted Rates for DS-3 Loops and DS-1 and DS-3 Transport Have No Merit.</u>

Verizon alleges that the Commission reduced certain DS-3 loop and DS-1 and DS-3 transport inputs in its final run of HM 5.3 such that it produced "below-cost rates, which differ substantially (and inexplicably) from the rates adopted in the SBC Decision" (which are now AT&T's rates).[43] Verizon is merely rearguing complaints that it raised in its comments on the

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[39] D.06-03-025 at 71-72.

[40] *Ibid.* at 72.

[41] JC/ Murray Decl., 11/9/04, Exhibit TLM-REB-3, CAPM Tab. The source documents for the updated inputs to Ms. Murray's CAPM calculation appear in Exhibit TLM-REB-4 to her November 9, 2004 declaration. The data used in Ms. Murray's update were current as of October 29, 2004. JC/ Murray Decl., 11/9/04, p. 3. These data are necessarily more current than the data on which the Commission relied in D.04-09-063, which was issued in September of 2004.

[42] (12.03% * 66.44%) + (6.15% * 33.56%) = 10.06%

[43] Rehearing Application, p. 8.

ALJ's Draft Decision and that were shown to be incorrect and misleading.[44] Moreover, Verizon misrepresents the difference between the rates adopted for it and for AT&T, which are generally not significant and are, most often, already in Verizon's favor.

Verizon first contends that the Commission's decision to update some HM 5.3 DS-3 loop electronics inputs "slashed HM 5.3's DS-3 loop rate from $1,352 to $592.73."[45] To put this into perspective, the Commission adopted a DS-3 UNE loop rate for AT&T California of $573.20.[46] Therefore, the Commission's decision to update the HM 5.3 inputs reduced the Verizon DS-3 loop rate from one that would have been more than 100 percent higher than the AT&T rate to one that is only somewhat higher than AT&T's.

More importantly, Verizon's Rehearing Application omits key facts and thus badly mischaracterizes the record. The inputs that Verizon attacks[47] reflect *Verizon's own actual contract prices* for this equipment and appeared in *Verizon's own cost study filed in direct*.[48] Verizon's Rehearing Application asks the Commission to maintain outdated material cost inputs in Joint Commentors' original HM 5.3 filing that Verizon's own data of record show to be *substantially* higher than Verizon's actual costs. Verizon cannot legitimately complain that it "was denied the opportunity to evaluate and comment on" *its own DS-3 electronics inputs* that were in the record, and supported by its own witnesses, from the very start of the proceeding. Modifying D.06-03-025 as Verizon suggests would result in rates that plainly exceed Verizon's actual forward-looking cost, contrary to the TELRIC standard.

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[44] Opening Comments of Verizon on Draft Decision, 12/14/05, pp. 10-13. As explained below, parties rebutted Verizon's complaints in their response to Verizon's comments on the Draft Decision and the Commission properly ignored the same arguments in its Final Decision. XO and CBeyond Comments Reply Comments on the Draft Decision, 12/21/05, pp. 7-8.

[45] Rehearing Application, p. 8, footnote omitted.

[46] D.04-09-063, Appendix A.

[47] Rehearing Application, pp. 8-9.

[48] XO and CBeyond Comments Reply Comments on the Draft Decision, 12/21/05, pp. 7-8. JC/

Verizon's remaining comments regarding DS-3 loop rates are made entirely without citation to the record and do not appear to be based on any evidence. Instead, Verizon is making a new, post-record request to apply factors it has derived from the SBC record relative to DLC inputs to these *different* DS-3 loop inputs.[49] It is striking that Verizon would make this proposal to cut-and-paste inputs from the SBC case (without reference to the Verizon record and out of context) given that Verizon originally argued that it is entirely inappropriate to import factors from the SBC decision.[50] Verizon's ability to pick and choose among the results that it favors is unmatched.

The basis for Verizon's change of heart argument for an SBC-case-based adjustment appears to be the claim that some adjustment (to its own inputs) is needed because the adopted inputs leave out installation labor. That claim is false. D.06-03-025 relies on an exhibit in which Joint Commentors show that the DS-3 inputs ultimately used in the Final Decision equal the total of Verizon's contract material costs plus costs for engineering, splicing, placing and testing the equipment.[51] Hence, there is no basis at all for making the adjustment that Verizon belatedly advocates.

Moreover, as the table below establishes, Verizon's overall premise that an adjustment is needed to bring its rates into reasonable correspondence with the adopted SBC rates is also false—except to the extent that the comparison indicates that the DS-1 rates adopted for Verizon

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Donovan, 11/9/04, Exhibit JCD-REB-14, "Input Tables for HIP" tab, cells H447:H449 and C479.

[49] Rehearing Application, pp. 9-10.

[50] Verizon Comments on the Draft Decision, 12/14/05, p. 4.

[51] JC/ Donovan, 11/9/04, Exhibit JCD-REB-14, "Input Tables for HIP" tab, cells D455:F466. Although Verizon's discussion is nominally about the Final Decision's DS-3 loop inputs, Verizon appears to complain that DS-3 transport inputs do not include installation. That assertion is also false. As JC noted, although the Transport Terminal Investment material inputs in HM 5.3 are labeled as "installed" cost, that label is incorrect and HM 5.3 subsequently adds installation costs to that total. *See* JC/ Donovan, 11/9/04, Exhibit JCD-REB-14, "Input Tables for HIP" tab, note at cell A1503 and HM 5.3 switching module inputs worksheet at cell E154.

are too high. Hence, while claiming the opposite, Verizon is actually arguing for modifications to D.06-03-025 that would create significantly inconsistent UNE rates relative to the adopted SBC rates.

Rate Element	**SBC Adopted Rate D.04-09-063**	**VZ Adopted Rate D.06-03-025**
Loop		
DS-1 Statewide	$ 57.42	$ 78.33
DS-1 Zone 1	$ 49.49	$ 67.70
DS-1 Zone 2	$ 64.25	$ 144.04
DS-1 Zone 3	$ 104.49	$ 552.37
DS-1 Zone 4	N.A.	$ 684.37
DS-3 Statewide	$ 573.20	$ 596.57

As noted above for DS-3 loop inputs, Verizon's complaints about the Commission-adopted interoffice input changes are complaints about the Commission's use of *Verizon's own actual cost data*.[52] Verizon's further complaints about interoffice modeling assumptions are nothing more than an attempt to reargue that HM 5.3 labor and other assumptions (for which Verizon proposed no alternatives in the record of the proceeding) are incorrect.

Again, Verizon attempts to rely on alleged inconsistency with the adopted SBC rates as its primary evidence. Yet, Verizon's Rehearing Application itself explains the fictional nature of the bulk of the supposed differential between the SBC and Verizon rates on which Verizon relies to justify rehearing. Verizon complains that the Final Decision divided the interoffice termination rate element adopted for Verizon by a factor of two, whereas no such adjustment was made in D.04-09-063 to calculate the corresponding rate element for SBC.[53] Verizon fails to observe that the transport elements *are also labeled differently and are deliberately stated on*

[52] XO and CBeyond Comments Reply Comments on the Draft Decision, 12/21/05, pp. 7-8.
[53] Rehearing Application, pp. 13-14.

different bases in the two decisions. In D.04-09-063, the transport termination rate adopted for SBC is stated on a "fixed" basis per dedicated transport facility, [54] *i.e.*, it applies once per facility. In contrast, the rate element that the Commission adopted for Verizon in D.06-03-025 is stated on a "fixed *per termination*" basis, *i.e.*, once at each circuit termination or twice per facility.[55] Hence, the Commission's different calculations simply correspond to the different definitions of the rate element in the two proceedings: because the transport termination rate element as defined in the Verizon docket is applied twice in pricing the UNE, it needed to be divided by two relative to the calculation in the SBC docket, where the transport termination element is defined so that it applies once. Because Verizon ignores that the adopted transport rates that the Commission adopted for SBC are applied differently, Verizon's claims in its Rehearing Application are based on meaningless apples-to-oranges comparisons.[56]

The following table reproduces the comparison provided in Verizon's Rehearing Application, but also restates the Verizon per-termination rate on a per-facility basis to provide the proper apples-to-apples comparison.

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[54] D.04-09-063, Appendix A.

[55] D.06-03-025, Appendix A, emphasis added.

[56] Verizon also overstates the difference between the Verizon and SBC rate elements by 100%, in addition to its apples-to-oranges comparison. For example, Verizon reports that the difference between the $3.76 DS-3 Transport Mileage rate adopted for Verizon in D.06-03-025 and the $4.81 rate adopted for SBC in D.04-09-063 is "131%." Rehearing Application, p. 12. In fact, the difference is only 31%.

Rate Element	SBC Rate D.04-09-063	VZ Rate D.06-03-025	VZ Claimed % Difference	Actual % Difference
<u>Dedicated Transport</u>				
DS-1 – Fixed *per Facility*	$ 34.05	$ 19.54 *	343%	74%
DS-1 – Fixed *per Termination*		$ 9.77		
DS-1 – Per Mile	$ 0.25	$0.13	192%	92%
DS-3 – Fixed *per Facility*	$ 483.95	$ 547.10 *	174%	(13%)
DS-3 – Fixed *per Termination*		$ 273.55		
DS-3 – Per Mile	$ 4.89	$ 3.67	131%	31%

* Note: The Verizon rate stated on a per-facilities basis is two times the per-termination rate.

Once the correct comparison is made,[57] one sees that the fixed component of the Verizon DS-1 transport element is only 74% lower than the SBC result (not 343%, as Verizon claims), and the DS-3 termination rate for Verizon is actually somewhat *higher* than what the Commission adopted for SBC. As noted above, this is just another illustration of Verizon's unprincipled approach of complaining that it is improper to even consider the SBC decision in setting Verizon's rates, but then complaining vigorously that it should get rates at least as high as the Commission adopted for SBC in those few cases where it will benefit Verizon.

It is not at all surprising that some of Verizon's transport rates should be lower than the rates adopted for SBC. The record establishes that material prices for transport equipment have been plunging, and the capacity of the technology has been advancing rapidly.[58] The resulting UNE prices adopted for Verizon should be lower to reflect those trends, given that the Verizon UNE prices are based on more current input data. Hence, there is no need to posit any error in

[57] The correct comparison for the fixed component of the transport rate is shown in the table below by comparing the Commission's adopted rate for SBC with two times the rate it adopted for Verizon, which is show in brackets beside the SBC rate.

HM 5.3 or the Commission's results to explain why Verizon's transport rates are not always higher than the rates adopted over a year earlier for SBC.

Indeed, it is only because the Commission (incorrectly) failed to consider a number of additional, important transport calculation updates that Joint Commentors proposed in rebuttal that the adopted rates for Verizon are not substantially lower.[59] For example, the Commission admits that it inadvertently changed many HM 5.3 material and other inputs to match figures that Verizon proposed in rebuttal (*i.e.*, that parties had no opportunity to examine or rebut), figures that Joint Respondents showed to be inappropriate for HM 5.3 and that substantially increase the adopted rate.[60]

Verizon also selectively omits mention of the fact that the Commission rejected important transport calculation updates that were proposed by Joint Commenters. Verizon persuaded the Commission not to consider that information only on timing grounds, *i.e.*, only because the information was brought forward in the rebuttal, not because it was inaccurate. Had the Commission incorporated these updates, Verizon's transport rates would have been substantially lower. Once the entire picture is considered, it can be seen that Verizon has no legitimate grounds for complaint.

C. <u>Verizon's Arguments Concerning the True-Up Have No Merit.</u>

Verizon claims that implementation of the true-up requirement in D.06-03-025[61] would constitute unlawful retroactive ratemaking. For the reasons set forth below, Verizon's arguments have no merit and should be rejected.

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[58] JC/ Mercer-Turner, 8/6/04, amended 10/12/04, ¶¶ 56-67.
[59] XO and CBeyond Comments Reply Comments on the Draft Decision, 12/21/05, pp. 7-8.
[60] D.06-03-025, p. 9. Joint CLECs Comments on the Draft Decision, 12/14/05, pp. 1-13.
[61] D.06-03-025, 2006 Cal. P.U.C. LEXIS 107, at *244, Ordering Paragraph ("OP") 4.

Verizon asks the Commission to engage in a bizarre and almost unbelievably complicated act of the imagination that, if adopted, will impose a severe injustice on CLECs in Verizon's service territory in California. Verizon asks the Commission to assume[62] that the interim UNE price adjustment clause adopted in D.03-03-033[63] will be stricken by the United States District Court for the Northern District of California (hereinafter, "the Federal District Court" or "the Court") in response to Verizon's February 21, 2006 Motion for Reconsideration[64] of the Court's 2005 order declaring that the interim UNE prices adopted in D.03-03-033 were not TELRIC-based and therefore invalid.[65] In other words, Verizon asks the Commission to assume that its adoption of a UNE price adjustment clause in D.03-03-033, by which it gave notice that the adopted interim UNE prices were "adopted on an interim basis and made subject to adjustment, either up or down, from [the date of that decision] until final [UNE] prices are adopted,"[66] has been undone somehow, such that the Commission's decision never happened and the Commission never gave notice for the UNE adjustment provision (although, as Verizon well

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[62] *See* Rehearing Application, pp. 14, 15, n. 59. In fact, if the Federal Court does not strike the 2003 interim UNE price adjustment clause as prayed for by Verizon, Verizon's entire argument falls to pieces. But even if the Federal Court were to grant Verizon the relief that it purportedly seeks (namely, the striking of the 2003 interim UNE price adjustment clause along with the interim 2003 UNE prices), the Commission would not be required to conclude, as Verizon falsely argues, that requiring a true-up pursuant to D.06-03-025 would constitute unlawful retroactive ratemaking.

[63] Rulemaking on the Commission's Own Motion to Govern Open Access to Bottleneck Services and Establish a Framework for Network Architecture Development of Dominant Carrier Networks, R.93-04-003; Investigation on the Commission's Own Motion into Open Access and Network Architecture Development of Dominant Carrier Networks, I.93-04-002 [D.03-03-033], __ CPUC 2d __, 2003 Cal. P.U.C. LEXIS 168 (dated March 13, 2003) (hereinafter, "D.03-03-033" or the "Interim Decision"). The interim 2003 UNE prices were later adjusted in D.05-01-057 (*see* n. 65, *infra*). Any reference herein to a true-up of the interim 2003 UNE prices is meant to include, by this reference, a true-up of the interim 2005 UNE prices as well.

[64] Verizon's Motion for Reconsideration is now scheduled for hearing before the Federal District Court on May 10, 2006.

[65] *Verizon California Inc. v. Peevey et al.*, No. C03-2838 TEH (N.D. Calif., rel. Dec. 5, 2005) (hereinafter, the "Federal District Court Order" or the "Court Order"). The Court's Order is entitled, "Order Granting in Part and Denying in Part Plaintiff's Motion for Partial Summary Adjudication."

[66] 2003 Cal. P.U.C. LEXIS 168 at *113.

knows, such notice obviously was given).[67] On the basis of this assumption (ignore the Commission's action and notice), Verizon then asks the Commission to find that a true-up of the 1997 UNE prices,[68] which Verizon asserts were retroactively reinstated by the Federal District Court as of March 13, 2003 (when the Commission adopted D.03-03-033), would constitute retroactive ratemaking. In effect, what Verizon is seeking is to have the 1997 non-TELRIC-compliant UNE prices reimposed on CLECs in place of the interim 2003 UNE prices adopted in D.03-03-033, so that CLECs would then be forced to pay Verizon the difference between the 1997 UNE prices and the 2003 interim UNE prices *instead of* the difference between the 2003 interim UNE prices and the 2006 permanent UNE prices.[69]

Simply to recite Verizon's argument is to recognize its utter implausibility. Just because the Federal Court found that the interim 2003 UNE prices were not valid TELRIC prices does not mean that the notice the Commission gave in D.03-03-033 that the interim prices were subject to future adjustment *disappeared*. As Joint Respondents explain in the discussion below, Verizon's bizarre attempt to deny or to undo the Commission's adoption of a UNE price

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[67] *See Rulemaking on the Commission's Own Motion to Govern Open Access to Bottleneck Services and Establish a Framework for Network Architecture Development of Dominant Carrier Networks*, R.93-04-003; *Investigation on the Commission's Own Motion into Open Access and Network Architecture Development of Dominant Carrier Networks*, I.93-04-002 [D.05-01-057], __ CPUC 2d __, no LEXIS citation available (rel. Jan. 27, 2005) at 7 (hereinafter, "D.05-01-057" or the "2005 Decision;" all references are to the Commission's *mimeo.* print). D.05-01-057 recounts, and adopts, Verizon's explanation of how the interim 2003 UNE prices should be trued-up against the final UNE prices. Hence it is inconceivable that Verizon contends that it did not receive notice of the UNE price adjustment clause in 2003.

[68] *See* In the Matter of the Petition of AT&T Communications of California, Inc., for Arbitration Pursuant to Section 252 of the Federal Telecommunications Act of 1996 to Establish an Interconnection Agreement with GTE California, Incorporated [D.97-01-022] 70 CPUC 2d 609, 1997 Cal. P.U.C. LEXIS 22 (hereinafter, "D.97-01-022" or the "1997 Decision").

[69] The difference between what Verizon wants and the true-up that D.06-03-025 provides for is quite substantial. For example, under the 1997 Decision, the two-wire voice-grade ("DS0") UNE loop price was $16.81. The 2003 interim DS0 UNE loop price (in Zone 1) was $10.56 (this was adjusted by the 2005 Decision to $10.32), a difference of $6.25. That is the refund from CLECs that Verizon now seeks. In contrast, a true-up between the 2003 interim DS0 UNE price (for Zone 1)($10.56) and the 2006 permanent DS0 UNE loop price ($11.93 for Zone 1) would be $1.37, approximately four to five times

adjustment clause in that decision has no merit. Verizon's argument misstates the rule against retroactive ratemaking. The Commission should stay the course on the true-up phase already underway.

In order to avoid engaging in retroactive ratemaking, the Commission need only give notice through an adjustment clause that the rates it is putting into effect are subject to an adjustment, up or down, at a future date (*e.g.*, upon adoption of a decision in the future). *See, e.g., Application of Southern California Gas Company for Authority to Update its Gas Revenue Requirement and Base Rates*, A.02-12-027 [etc.] [D.05-03-023] __ CPUC 2d __, 2005 Cal. PUC LEXIS 127, *37-38 ("We earlier found . . . adoption of the final test year revenue requirement was *not retroactive ratemaking when it was made subject to refund in the interim . . . decision*, D.03-12-057 [where the Commission simply stated, *inter alia*, "Interim rates will be corrected by refund, as necessary"]") (emphasis added); *In the Matter of the Application of Pacific Bell, a corporation, for authority to increase certain intrastate rates* [etc.], A.85-01-034 [D.88-01-056] 27 CPUC 2d 309, 1988 Cal. P.U.C. LEXIS 57;[70] *Oxy USA, Inc. v. FERC*. 64 F.3d 679, 699 (D.C.

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less than the amount that Verizon now seeks, per DS0 UNE loop per month for the last three years.

[70] The Commission stated: "In any event, there are several reasons why the subject to refund provision of the Decision does not violate the rule against retroactive ratemaking. [¶] The Commission may properly subject a utility's rates to refund to account for adjustments to be made pursuant to a methodology, or formulas, adopted before the date the utility's rates become subject to refund. Any ratemaking is prospective because the formulas are in place before the utility's rates become subject to refund. The California Supreme Court has approved the use of adjustment clauses and noted the importance of the time when the Commission adopts the methodology, as compared with the relative unimportance of the time of its application. See City of Los Angeles v. Public Utilities Commission, 15 Cal. 3d 680, 695-703 (1975); Southern California Edison Co. v. Public Utilities Commission, 20 Cal. 3d 813, 823, 828-30 (1978). . . . [¶] The Commission does not engage in unlawful retroactive ratemaking when it first makes a utility's rates subject to refund for a specified purpose (beginning on a future date) and thereafter calculates the amount to be adjusted starting from the date the utility's rates became subject to refund. See Southern California Gas Co. v. Public Utilities Commission, 23 Cal. 3d 470, 487 (1979). [¶] The rule against retroactive ratemaking applies only to the promulgation of general rates. The Commission does not engage in such general ratemaking when it applies adjustment formulas and therefore the rule against retroactive ratemaking does not limit the Commission when it orders adjustments pursuant to such formulas. See SoCal Edison, 20 Cal. 3d at 816-17, 828-30. See also California Manufacturers Association v. Public Utilities Commission, 24 Cal. 3d 251, 261 (1979)." *Id.* at

Cir. 1995);[71] *see also*, *Southern California Edison Company v. Public Utilities Commission*, 20 Cal. 3d 813, 828-30 (1978); *City of Los Angeles v. Public Utilities Com.*, 15 Cal.3d 680 (1975). As the Commission well knows, the process by which rates are adopted on an interim basis and made subject, through notice, to future adjustment, up or down, is a common practice at the Commission, and it would come as an astounding piece of news to every lawyer practicing before the Commission if the Commission could not make rates subject to refund *simply by giving notice that they were subject to refund*. In fact, if a true-up clause adopted in a Commission decision adopting rates on an interim basis were itself invalid simply because the interim rates were later found invalid (the *exact* result for which Verizon is contending here), the Commission might never adopt rates on an interim basis at all, for fear of not being able to remedy either under- or over- collections in the future. If this is the law, then it represents a result for which the state's energy utilities would no doubt *not* thank Verizon. In short, Verizon is attempting to foist an overly technical, and ultimately absurd, version of the rule against retroactive ratemaking on both the Federal District Court and the Commission. The Commission should reject it as such.[72]

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*4-*5.

[71] As the Court in *Oxy USA* states: "The rule against retroactive ratemaking . . . 'does not extend to cases in which [customers] are on adequate notice that resolution of some specific issue may cause a later adjustment to the rate being collected at the time of service.' [Citation omitted.] The goals of equity and predictability are not undermined when [an agency] warns all parties involved that a change in rates is only tentative and might be disallowed." *Id.* at 699.

[72] Verizon's reliance on *Qwest Corp. v. Arizona Corporation Commission*, 349 F. Supp. 2d 1228 (D. Ariz. 2004) is very badly misplaced. In that case, as the decision makes clear, the rates that the Arizona Corporation Commission sought to change retroactively were *not* imposed subject to refund. As the Court observed:

> First, the defendants contend that the general rule does not apply to interim rates. Thus, if the *Phase II* rate had been established as an interim rate, retroactive application of the 1998 rate would not be unlawful. Had the ACC instituted the HAI combined transport rate as an interim rate instead of a permanent rate in the *Phase II Order*, the ACC's actions would not have violated the rule against retroactive ratemaking. *Generally speaking, the general rule against retroactivity is inapplicable when there is "adequate notice that resolution of some specific issue may cause a*

Verizon is essentially arguing that, because the specific interim prices the Commission set in 2003 have been overturned, it should be exempted from the true-up requirement clearly set forth in D.03-03-033 and should thus be able to retain benefits it received from overcharging competitors for UNEs (relative to the permanent rates ultimately adopted in the Final Decision) for the entire time that interim rates were in place. Verizon seeks to add insult to injury.

Until D.06-03-025, the Commission had never adopted permanent, TELRIC-compliant UNE prices for the Verizon California area.[73] When the Commission adopted interim rates, it made very plain that those rates were interim and subject to true-up to permanent rate levels.[74] This is precisely the same pattern the Commission adopted, and implemented, for SBC/AT&T.[75] If Verizon truly believed that the Commission's intention and practice was inappropriate, it

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later adjustment to the rate being collected at the time of service." OXY USA, Inc. v. FERC, 314 U.S. App. D.C. 175, 64 F.3d 679, 699 (D.C. Cir. 1995) *quoting* Natural Gas Clearinghouse v. FERC, 296 U.S. App. D.C. 104, 965 F.2d 1066, 1075 (D.C. Cir. 1992). However, it is clear here that the *Phase II* rate was not interim but permanent. At oral argument, the ACC acknowledged that the *Phase II* rates were not expressly interim:

> Originally the Commission set rates in the Phase I order that were expressly interim. With regard to the Phase II order, it did not, as Qwest points out, we did not use that language, although the Commission did point out that there was some data that they wanted to consider that was not available in the record at that time. Rep.'s Excerpted Tr. 5-6.

The language in the *Phase II Order* does not designate the rates as interim, but instead explicitly "adopts the HAI model's results for purposes of pricing transport in this proceeding," and notes that the rates should be "re-examined in Phase III so that a full record may be developed." *Phase II Order* at 79. Such a statement does not create an interim rate. If the ACC intended the *Phase II* rates **[**12]** to be interim, its *Phase II Order* certainly *did not provide notice* to any party, including Qwest. The exception, thus, is inapplicable.

Id. at 1232 (emphasis added). Verizon cannot possibly contend with a straight face that D.03-03-033 did not give it adequate notice that the interim 2003 UNE prices were adopted subject to future adjustment, up or down. Verizon's citation of the *Qwest* decision is a clear misstatement of what the case actually says, and the Commission ought not to tolerate such argument.

[73] D.03-03-033, p. 3.

[74] *Ibid.*, pp. 3-12. Notably, a significant portion of the reason that it took so very long for the Commission to adopt permanent UNE rates for Verizon is that Verizon kept filing insufficient studies and legally challenging Commission (and FCC) decisions, as it is continuing to do now. *See*

[75] *See* D.02-05-042 and D.04-09-063.

should have challenged the true-up requirements explicitly set forth in D.03-03-033 and D.05-01-057. Yet, it did not do so. Now Verizon proposes that the Commission should ignore this long history and excuse it from its true-up obligations, based on a promissory note it does not actually own, namely, Verizon's representation that it "expects," in the future, to win a ruling from the Federal District Court. Granting Verizon the relief that it seeks would deprive all Verizon's competitors of the actual TELRIC-based UNE prices that they have been entitled to all along.

There are two significant problems with Verizon's argument. First, the Court has not granted Verizon the relief that it seeks and, in federal court, the Commission itself is contending that Verizon should not win such relief. Second, and more importantly, even if the Court did grant Verizon the relief it seeks, Verizon's reliance on the rule against retroactive ratemaking in its Application for Rehearing is misplaced: the rule against retroactive ratemaking under P.U. Code § 728 does not even come into play if, as occurred in this instance, the Commission has given notice that rates are subject to future adjustment, up or down.[76] The notice of future rate adjustments in D.03-03-033 does not disappear (and Verizon has shown no precedent that notice of future adjustment would simply disappear) simply because the interim rates adopted in D.03-03-033 were later found invalid in federal court.

Verizon's new attempt to eliminate retroactive adjustments is ironic because, as the Commission noted in D.05-01-057, Verizon was very concerned, in that setting, about how to implement a retroactive adjustment.[77] Unlike now, Verizon's concerns at the time seemed to be about making sure that the rates were billed as accurately as possible. The Commission should see through Verizon's belated attempt to ignore its prior insistence on how the true-up should be

[76] *See* cases cited at nn. 70-72, *supra*.

conducted. D.03-03-033, D.05-01-057 and D.06-03-025 gave Verizon and all parties full notice as to how the UNE price adjustment clause would operate in the future.

Therefore, the Commission should reject Verizon's groundless request to invoke the rule against retroactive ratemaking in support of its claim for rehearing of the true-up issue. Instead, the Commission should move forward with the true-up phase of this proceeding, which is already underway.

III. CONCLUSION

For the reasons stated above, Joint Respondents respectfully request that the Commission reject Verizon's Rehearing Application in its entirety.

Respectfully submitted,

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Dated: May 4, 2006

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[77] D.05-01-057, pp. 4 and 8.

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Certificate of Service

I, Earl Nicholas Selby, hereby certify that on May 4, 2006, at Palo Alto, CA, I caused an electronic copy of the foregoing document, entitled:

**RESPONSE OF CBEYOND COMMUNICATIONS, LLC (U-6446-C),
COVAD COMMUNICATIONS COMPANY (U-5752-C),
THE DIVISION OF RATEPAYER ADVOCATES,
DMR COMMUNICATIONS, INC. (U-6735-C),
MPOWER COMMUNICATIONS CORP. (U-5859-C),
NAVIGATOR TELECOMMUNICATIONS, LLC. (U-6167-C), AND
XO COMMUNICATIONS SERVICES, INC. (U-5553-C)
TO APPLICATION OF VERIZON CALIFORNIA INC. (U 1002 C)
FOR REHEARING OF D.06-03-025**

to be served on the parties to the above-captioned proceeding by electronic mail, addressed as shown on the following page, using the addresses available from the electronic service list on the Commission's Web site as of May 4, 2006.

I certify that the foregoing is true and correct.

Dated May 4, 2006, at Palo Alto, CA.

/s/ *Earl Nicholas Selby*
Earl Nicholas Selby

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